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STATE FOR WHA/CAR (WBENT), WHA/EPSC (JSLATTERY)

SANTO DOMINGO FOR FCS AND FAS

E.O. 12958: NA
TAGS: ECON EFIN JM
SUBJECT: JAMAICAN ECONOMIC PERFORMANCE IN 2005: A YEAR OF MISSED TARGETS

Ref: A.) Kingston 555

B.) Kingston 748

SUMMARY

¶1. Data published by the Planning Institute of Jamaica at the end of April shows that the country missed its main economic targets during 2005. Real GDP growth of 1.4 percent was below the original target of 3.6 percent, due to weather-related and oil price shocks. These contributed to rising prices, leading to inflation of 12.9 percent, above the GOJ target of 9.0 percent. The ensuing economic fallout impacted central government's operations, which generated a fiscal deficit of USD 444 million. However, the foreign exchange market remained relatively stable, underpinned by robust international reserves. Economic performance improved during the first calendar quarter of 2006, with output expanding by 1.4 percent, despite a cement crisis (ref. A). Inflation slowed to 0.1 percent and the foreign exchange market maintained stability, setting the stage for a reduction in interest rates. Nevertheless, the country will have a difficult time achieving its economic targets during 2006 due to the cement fiasco, high oil prices, and a hurricane season that is forecast to be damaging. End summary.

Output Stagnates Amidst High Inflation

¶2. Data published by the Planning Institute of Jamaica on April 27 shows that the Jamaican economy recorded marginal growth of 1.4 percent during 2005. Construction, tourism and mining provided the major thrust for growth. While this was the seventh consecutive year of growth, the figure was well below the GOJ target of 3.6 percent due to various shocks related to weather conditions and high oil prices. These, combined with a number of policy-induced shocks (such as increases in the minimum wage and the general consumption tax (GCT)), provided significant impetus for prices, which rose by 12.9 percent during
¶2005. While this result is lower than the 13.7 percent increase recorded in 2004, it exceeded the 9.0 percent target, suggesting that the GOJ has yet to stem the upward trend in inflation observed since 2003.

Fiscal Position Deteriorates

¶3. The weak economic performance also impacted the country's fiscal accounts, with central government operations generating a deficit of USD 444 million or 3.1 percent of GDP. The GOJ had programmed a balanced budget for fiscal year 2005/06, but with two hurricanes and a deficit of USD 443 million for the first nine months the target was revised to two percent of GDP. The revision was largely due to a falloff in revenues - despite the 1.5 percentage points increase in GCT - suggesting either increased tax evasion, a reduction in consumption, or a combination of both factors. Revenues were also predicated on more buoyant economic growth and the relatively poor performance therefore affected collections. Expenditure for the fiscal year was 2.4 percent below projections, as the GOJ made adjustments to compensate for the revenue shortfall. While these fiscal adjustments appeased the capital markets, they made a further dent into the already limited capital budget required for social and physical infrastructure.

.... But Monetary Policy on Track

¶4. After years of high interest rates to contain demand impulses, rates continued to decline, with the average benchmark and loan rates falling to 13.4 and 17.3 percent, respectively, at the end of 2005. The foreign exchange market also remained stable, supported by Jamaica's healthy NIR (USD 2.1 billion) during the year. The rate moved from JMD 61.85 per USD 1.00 at the end of 2004 to JMD 64.67 per USD 1.00 at the end of 2005. This represented a nominal depreciation of 4.6 percent, but an appreciation of about 8.3 percent in real terms after

accounting for inflation, suggesting that the country continues to lose competitiveness. If Jamaica's inflation remains above that of its international trading partners, there could be a major correction in the exchange rate in the short to medium term.

First Quarter Growth Stalled

¶5. There was a brief recovery in economic performance during the first quarter of 2006, with GDP increasing by 1.4 percent, reflecting robust agriculture and tourism sector growth. Agriculture surged by 24.7 percent due to favorable weather conditions, while stop-over arrivals jumped by 10.8 percent following another record winter tourist season. Output growth would have been more significant were it not for a spate of industrial disputes (ref. B), some leading to work stoppages at the country's four bauxite companies. These contributed to a 2.2 percent decline in mining output, a sector which has grown by double digits in the last two years. Even more significant, however, was the continued cement debacle (ref. A), which has crippled the fast-growing construction industry, leading to a 6.3 percent drop in the sector.

¶6. Despite the chronic cement shortage and high oil prices, inflation moderated to a respectable 0.1 percent during January to March 2006. Inflationary impulses were tamed by an increase in domestic food supplies and a relative stability in oil prices. The lower inflation figure allowed the economy to recover some lost competitiveness during the period, as the exchange rate depreciated by 2.5 percent in real terms. At the same time, private investment inflows increased and the stock of NIR climbed to USD 2.2 billion. These improved economic fundamentals set the stage for the monetary authorities to reduce benchmark interest rates to 12.8 percent as well as remove the one percent special deposit

imposed on commercial banks in 2003 to stabilize the financial sector. (Note: The special deposit was initially set at five percent, but was reduced to one percent in two steps between February and May 2005. End note.)

COMMENT

¶7. Economic growth will likely remain sluggish during April to June, as the cement crisis drags on. Realizing the three percent growth target for 2006 will therefore depend on a speedy resolution to the cement saga to kick-start the construction sector. Growth will also depend the industrial relations climate in the private sector. However, mining and tourism activities should contribute handsomely, as both have already posted increases during April. Inflationary impulses emerged for the first time in April, with inflation rising by 1.1 percent due to higher oil and food prices. Inflation is predicted at 10 percent this year, but achieving this target will hinge on stable domestic food and oil prices. The foreign exchange market should continue to benefit from relatively buoyant inflows from tourism, remittances and private investment receipts. Therefore, in the absence of shocks, the exchange rate is expected to continue depreciating in an orderly manner during the year. However, this managed depreciation might not be sufficient to recover the competitiveness lost during 2005. End comment.

JOHNSON